THE NATIONAL CITY BANK OF NEW YORK

1918

Economic Conditions
Governmental Finance
United States Securities

NEW YORK, OCTOBER, 1918.

We have always maintained that the country could pay for all the work it could do. Before it can do any war work it must necessarily provide for its own essential wants. The work done for the Government is all beyond and outside of the work which is necessary to feed, clothe and care for our people. In other words it represents surplus income, and as surplus income we can take it in the Government's promises to pay at a future date. The problem is only that of gathering up our resources.

Fourth Liberty Loan.

THE Fourth Liberty Loan offering is for $6,000,000,000, the largest loan ever proposed. The interest rate is the same as upon the Third Loan, 4¼ per cent. The bonds will mature on October 15, 1938, but the United States has the option of payment on and after October 15, 1933. A special feature is an exemption of the income from these bonds up to $30,000 in the hands of one holder from surtaxes and excess profits and war profits taxes, until two years after the end of the war. Furthermore, a taxpayer who subscribes for $30,000 of these bonds and still holds them at the time of making his income return will also be granted a similar exemption upon the income from $45,000 of the Second and Third loans, and subscribers in lesser amounts will be granted a like proportionate exemption. The selling campaign began on September 28 and will close on October 19. The allotment by Federal Reserve Districts is as follows:

District.	Per cent.	Amount.
Boston	8.33 1-3	$ 500,000,000
New York	30.00	1,800,000,000
Philadelphia	8.33 1-3	500,000,000
Cleveland	10.00	600,000,000
Richmond	4.66 2-3	280,000,000
Atlanta	3.20	192,000,000
Chicago	14.50	870,000,000
St. Louis	4.33 1-3	260,000,000
Minneapolis	3.50	210,000,000
Kansas City	4.33 1-3	260,000,000
Dallas	2.10	126,000,000
San Francisco	6.70	402,000,000
Total	100.00	$6,000,000,000

The allotment is in slightly different proportions from that of the Third Loan, the Treasury having taken account of financial conditions in the several sections.

In many localities the organization for taking subscriptions was well under way before the formal opening, and "over the top" announcements are expected earlier than heretofore. The offering is not only double that of the Third loan, but the task is made more difficult by the prospective doubling of taxes, which lessens the ability of the class from whom large subscriptions must come. Nevertheless, there is general confidence about the outcome. With the boys winning victories as they are in France, there must be no shrinking from the task to be performed at home.

Taxation.

The new revenue bill to provide $8,000,000,000, having passed the House is now under consideration in the Senate Committee. It is not supposed that the amount sought to be raised will be lowered or that personal income taxes will be materially altered. Strong representations will be made for some modification of the taxes upon business profits. The objections to the proposed taxes of this class are, in brief, that the nominal profits of business concerns at this time do not exist in cash and cannot be withdrawn to the extent required without liquidating and curtailing the operations of the companies to a serious degree. The high cost of labor and materials, increased freight charges and other expenses require so much more capital that even where the apparent profits are large they cannot be spared and in many instances resort must be had to borrowing.

Furthermore, there is earnest representation that these book profits are to a great extent illusory, and will never be realized. They are largely accounted for in the inventories of materials on hand, valued at cost or present market prices, and are in fact assets of very uncertain value. Sooner or later all of these inventories must be marked down, and when this is done the profits now shown on the books will largely disappear.

Instances are not uncommon where companies will have trouble in borrowing the money required to pay their taxes, for bankers are fully aware of the doubtful character of the profits in sight and have no inclination to discount them.

These are times when taxes of necessity must be heavy, and it is worse than useless to utter complaints merely because they are heavy, but all the more care should be exercised that taxation shall not be unjust. A tax that is fully justified when levied upon profits actually realized may be very unfair if imposed upon book profits which are calculated upon materials in stock at present prices. Men do not expect to go out of business in order to realize these profits for the purpose of paying taxes, and it is not to the public advantage that they shall do so. Men go on with their business even when they know that a great shrinkage of values is inevitable, but some recognition of the ephemeral character of book profits at present should be given in levying taxes on them.

Provision is made for amortizing the value of buildings erected especially for war purposes, and it does not seem impossible to arrange for reasonable reservations to provide for the shrinkage of inventory values, such reservations to be finally accounted for at a later date.

Uncertain Profits.

The American Smelting and Refining Company in one of the companies that figured conspicuously last year in the list of companies said by the advocates of extreme taxation to be making extravagant profits. It was named in the report of the Federal Trade Commission upon Profiteering. This company paid 6 per cent. dividends on its common stock last year, and, according to its statement just issued, in the first six months of 1918 barely earned the 3 per cent. necessary to maintain the dividend. The surplus of last year all went into the business, and largely, according to the President's report, into extensions necessary for the handling of war business, but which otherwise will be a dead investment for some time to come. Stockholders have had no more than 6 per cent. Cost and inventories are now on a high level, and the $100 shares are selling at $78.

We are in receipt of a letter from an important company which sets forth one objectionable feature of the bill as it has passed the House, as follows:

A point which we would like to bring to the attention of your Tax Department will be of extreme importance to your customers in the manufacturing line, although it has no particular bearing on the business of a bank. The 1917 law distinctly sets aside dividends received by an individual according to the year in which the dividends were earned. It is the practice of many corporations in the manufacturing line to wait until the end of the year to determine the amount of their profits, because of the uncertainties of business, and the result is that many of them declare their dividends in January after closing their books for the preceding year. The proposed law indicates that this plan will be abolished and therefore the effect on the income of the individual is to make him pay the immensely increased tax on the basis of the 1918 law for the dividends received in January on 1917 business.

Furthermore, many individuals have set aside a reserve to pay their tax for this 1917 profit on the basis of the 1917 law, and it will be a hardship for them to pay double this amount if the new law is permitted to pass without the same provision being held for the allocation of dividends that was applied in the 1917 law.

Inflation.

The effects of inflation have been visible for some time in wages and the prices of commodities, but not in the prices of securities or of real estate. This fact is the subject of much inquiry and comment. If inflation is a factor of general import, as it is supposed to be, affecting the purchasing power of money, why doesn't it show in the prices of bonds and stocks and of real estate? What is modifying or retarding its influence in these quarters, and will its effects appear in these prices later?

Defining Inflation.

As the first step toward any discussion of inflation it is necessary to have an understanding of the term. Some persons apply it only to an undue expansion of paper currency, but an expansion of bank loans and deposits has the same effect, since checks are now the common medium of payments. Others in referring to inflation have in mind a general state of abnormally high prices incidental to great industrial activity, whatever the primary cause may have been. Many people argue that the inflation of credits at this time is wholly the result of the war demands, but they take no account of the part played by an increased supply of credit or money in facilitating the demands. In time of peace a country's industries are occupied in supplying its consumptive wants and in construction work to enlarge its powers of production. If, when a country goes to war, it would curtail these accustomed demands enough to offset the new war demands, there would be no rise of prices. But people do not curtail their accustomed demands to any such extent. They go on trying to buy and consume as usual, and since there is not labor enough to do everything, employers raise wages to get labor away from each other, and all prices and costs rise. More credit is required to handle all business under these conditions, but whatever amount of credit is supplied is quickly absorbed, because the bidding for labor and materials continues. In short, each new supply of credit finances a further rise of prices, because costs and prices follow each other around a circle.

It is this relation of credit to price inflation that we are now discussing. The prevalent idea seems to be that since an undue expansion of the medium of exchange has the effect of diluting and depreciating it, the depreciation should be the same in relation to all kinds of property. This is not the effect, for the simple reason that there is not an equal demand for all kinds of property. In other words, the depreciation of the currency, or purchasing agency, does not occur simply as a result of increasing quantity, but from increasing competitive efforts to exchange it for something else. If there was no attempt to use enlarged purchasing facilities there would be no effect upon prices. There is

no abstract calculation or measurement of values, but an ordinary operation of the law of supply and demand. A greater relative supply of currency, accompanied by strenuous efforts to exchange it for certain things which are of immediate importance, causes the currency to lose purchasing power with relation to those things.

War the Primary Cause.

The primary cause of this great rise of wages and prices of course is the war. It has taken millions of men from the industries and set up an enormous demand for the war supplies. It has given an abnormal value to everything that can be made serviceable for war purposes or that supplies immediate needs. There is a strenuous effort to expand the production of these necessary supplies. All energies are directed into this channel. In the endeavor to accomplish this expansion along certain lines an expansion of credit occurs, but the use and influence of this credit is closely confined to these lines. Indeed the expansion of credit in part results from efforts to transfer capital from other lines. Owners mortgage or sell out fixed investments in other kinds of property at a sacrifice for the purpose of converting their capital into war uses. They sell municipal bonds, railway bonds, stocks, real estate, etc., in order to buy Government offerings or to supply capital to the war industries.

A few stocks have gained in market value because the financial condition of the companies has improved, but as a rule, market gains do not equal the gains in assets. One reason for this probably is that uncertainty hangs over the prospects for business after the war, but another is that the investing power of the country is being directed into other channels. Formal notice has been given to the New York Stock Exchange that credit expansion for the purpose of stock purchases will not be permitted, but even before this notice was given borrowing upon stocks had been voluntarily reduced to a point much below normal.

Real estate does not feel the expansion of credit because almost none of the new credit is being used for the purchase of real estate. Nobody wants vacant, unproductive real estate at a time when the cost of improvements is double that of normal times. Real estate feels the stimulus only if within the field of war activities; otherwise it is depressed by the lack of demand and the efforts to convert such property into cash for investment in other fields.

Will Stocks Feel Inflation.

How long will this condition exist? When may a tendency to equalize the effects of inflation be expected to develop?

The answer is that there is no certainty that the effects of inflation will reach stocks. That is to say, general deflation may come before the effects of inflation reach stocks. It depends upon conditions after the war.

When the war comes to an end and offerings of Government bonds cease, undoubtedly the situation will change, but so many changes will occur that it is not safe to predict what the result will be.

If industrial activity and earnings continue as at present after the Treasury drops out of the market as a borrower, it is safe to predict that capital will flow into the general investment market, and stocks, bonds, securities and real estate will receive their normal share of attention, and benefit accordingly, but this is assuming the very conditions about which there is uncertainty.

Stocks represent proprietary interests in companies whose assets consist of land, buildings, machinery, materials, goods, etc. If labor costs were established on the present level to stay, it would be impossible to duplicate these properties except with a much higher capitalization than they have, and this fact would naturally raise their capital value and thus bring about higher prices for the certificates of ownership. This is the method by which logically the effects of inflation would spread to stocks. But labor costs probably will decline after the war, and it is also to be considered that in many lines a large increase of capacity has been developed during the war and costs written off out of war profits. It is not probable, therefore, that the high costs of duplicating existing plants will be a present influence after the war.

Industrial Conditions Will Govern Prices.

To sum up the status of stocks, securities, real estate, and such other forms of property as have not shown the influence of credit inflation, the explanation is that credit inflation acts upon prices only as it increases demand, and in the instances named the demand has not been increased. On the contrary, the expansion of credit is itself a symptom of a general effort to convert, pledge or subordinate other forms of property to the forms which are more immediately serviceable in the war emergency. The war influence dominates, depressing some values and enhancing others.

After the war is over, there will be a change of all conditions. When the Government orders are finished and paid for, unless a similar volume of equally urgent demands spring up from new sources the inflation of credits will subside. Bank loans and deposits will decline and the percentage of bank reserves will rise. This would mean a readjustment of values toward the pre-war basis. Evidently the course of this readjustment will be governed by the industrial situation and prospects at that time. If the transition from war conditions to peace conditions is fortunately accomplished; if industry is well sustained and free from disorganizing controversies, so that both the investing and consuming power of the country is large, the establishment of a feeling of full confidence is likely to be followed by one of the greatest periods of construction and expansion the coun-

try has ever known. The future of wages, prices and values in general will depend upon harmonious, highly organized, efficient, well-balanced industry, creating new wealth at a rate sufficient to satisfy the growing wants of the people.

Credits at the End of the War.

Will this state of inflation end with a collapse of credit after the war? It is safe to say that the credits which have been created for war purposes in this country will be generally liquidated at the end of the war without losses, because they rest at last upon the credit of the Government. When the Government purchases fall off and its contracts are liquidated, there will be a general liquidation of private indebtedness related to war work, and war work is now the chief factor in industry.

There has been no considerable expansion of credit outside of the war industries. Building operations and new construction of all kinds are at low ebb, except as related to the war industries; real estate is inactive, loans for the purchase of stocks and securities are lower than usual, and the prices of stocks, bonds and real estate are below rather than above the normal level.

These are not the conditions under which panics occur from an over-extension and collapse of credit. It is evident, therefore, that although an abnormal expansion exists at this time the situation is different from that of a boom period, when credit is over-extended upon the basis of more or less speculative private enterprises, about which confidence may be eventually weakened. The statements of corporations generally show that their financial condition has improved in the last three years. They have made only moderate distributions from earnings, have reduced their bonded indebtedness, and although current indebtedness is large, that should be covered by the orders in hand.

A tight rein is being held upon every tendency to use credit outside of essential purposes, and there is little temptation or opportunity to use it along venturesome lines. As a result there is less uncertainty about the credits of the country than in ordinary times, and there is no danger of anything like a general breakdown or panic while the present situation exists.

The danger of a credit collapse will come, not in the liquidation of the credits now outstanding, or of succeeding credits based upon war business, which practically have the credit of the Government behind them, but at the end of the boom period, if there should be one following the war, when credits will have nothing behind them but private enterprise and promises, and the whole situation is based upon an inflated and uncertain state of values.

After the War Industry.

We may expect that after the war there will be a waiting demand for many kinds of goods and equipment so urgent that for a time price will be a secondary consideration. The whole world is doing without things that it would gladly buy, wearing out equipment and falling behind its wants. It is falling behind in housebuilding, for example, in road-making, in railway extensions and in the development and improvement of public utilities. Automobile construction has nearly ceased, and the cars in use will be nearly worn out. Clothing will be worn out the world over, and stocks of cotton will be low, therefore there will be a good market for cotton and our cotton states should be prosperous. Not only is there the rebuilding and rehabilitation of the war-devastated districts to be done, but the development of the backward countries looms up with more definite and immediate promise than ever before. The world is not going to seem so large, or its divisions so separate and distinct from each other as in the past. Foreign countries will not appear so remote and difficult of access to Americans. Undeveloped resources which will contribute to the comfort and welfare of mankind will not be neglected anywhere if stable government and protection to investments can be had. The stir of the war will be in the blood of all nations and the impulse to do things will be manifest. These are the conditions favorable to a period of enterprise and activity, and which will tend to sustain prices or moderate their decline.

The Decline of Prices.

Nevertheless, it is inevitable that prices will be upon a declining scale and this will be the factor of uncertainty and danger in the situation. Falling prices, shrinking values in inventories, stocks of goods and capital investments, have a depressing influence. It is comparatively easy to make money when prices are rising; the most venturesome may be the most successful then. Errors of judgment are made good by something outside the management. Farmers of even indifferent skill, who could make but a poor showing of profits from their farming operations, have become well-off from the rise of land values. The situation is very different with prices on a declining scale, for then not only is there no margin furnished gratuitously by an unearned difference between buying and selling prices, but a portion of the normal earnings is lost, and as net earnings decline, capital values shrink, credit is unfavorably affected, and indebtedness becomes relatively heavier and more burdensome. Therefore it is in order to give warning against incurring indebtedness which will reach over into the period after the war, when prices and earnings will be lower than now. Prices must decline, for one reason, because the conditions which occasioned the rise will be reversed. The millions of men withdrawn from industry will be returned to it, and the millions of women who have entered industry will not all leave it. Although it is true that there is a

vast amount of work waiting to be done, private employers will count the cost of capital investments more carefully than the Government counts the cost of war supplies, and the demand for labor even if sufficient to absorb the great supply, will not be so urgent as in wartime. It is probable that the governments will take action during the transition period to provide employment, but constructive work will enlarge the facilities of production and increase the flow of products, and thus contribute eventually to the fall of prices.

The inventive genius and energies that have been active during the war in other channels will be applied to the task of suplying the common wants of the population. Many lessons both in production and economy have been learned which will be of lasting value. Science is constantly making discoveries which cheapen industrial processes, and science is being applied to industry more systematically than ever before. The decline of prices which results from such economies is not harmful to those able to take advantage of it but it is likely to be serious to those who do not keep up with the movement.

The basic industry, agriculture, whose products are the chief factor in living conditions and in the wage question, and therefore closely related to costs in all industries, is susceptible of great improvement in methods, and some are under way. Plans are being laid in several of the countries at war for placing ex-soldiers upon land, and in the United States the Secretary of the Interior is developing a plan to that end. With the exception, possibly, of live stock, it is probable that farm products will soon find their way back to former levels, and if so this will have a powerful influence upon other prices. It is safe to say that the workers in agriculture will not be satisfied to exchange products with workers in other industries on a basis less advantageous to themselves than in the past.

The Gold Standard.

There is another reason why prices must come down after the war, and that is that unless they do the monetary systems of the whole world will have to be reorganized in a manner which will not only do great injustice to all persons who hold a creditor position, but involve business affairs generally in such confusion as will disorganize production and the exchanges and occasion losses to all classes.

The monetary systems of the world almost without exception, are now based upon gold. The monetary units of nearly all countries are fixed in terms of gold, and since they all have a fixed relation to the grain of gold it follows that they have a definite relationship to each other. This is favorable to international commerce and financial relations. China has been the only important country whose currency was not related to the gold standard, but its government has taken steps within the last month for establishing such relationship. The great service of this common unit of value in world affairs is illustrated and emphasized at the present time by the difficulties which arise because temporarily the free movements of gold are interrupted.

Gold Mining Unprofitable.

But the present rise of prices has destroyed the normal relationship between gold and other commodities. Gold is priced in terms of itself; an ounce of it will bring $20.67 at the United States mint, because at the coinage rate an ounce will make that amount of money. There is no magic about the act of coinage. The word "dollar" is simply the name given to 25.8 grains of gold nine-tenths fine. The Government does not attempt to determine the exchange value of the "dollar"; that depends on the law of supply and demand, and unfortunately for the gold producers there are other ways of producing dollars than by digging gold, and just now there is a great output of "credit" dollars. Since there are restrictions upon the disposition of gold outside of the mint, he can get no more than the mint price, and the cost of mining gold has risen until mines of low grade are working at a loss or closing down, thus reducing the new supplies.

The production of gold cannot be maintained at its present valuation in relation to other commodities. That is to say, with labor, coal, machinery, chemicals and other supplies necessary to its production at present prices, gold cannot be produced at a profit to be coined at $20.67 per ounce.

Gold, Credit and Prices.

While the war goes on credit will be artificially elastic in order that the necessities of the Government may be met, and the risk of credit expansion is minimized, as stated above, by the fact that Government credit is so largely behind the situation; but when the war ends this reduction in the output of gold is bound to make itself felt in the credit situation. The normal additions to banking reserves will not be made, and credits will be correspondingly restricted, with the result that prices will decline. The influence is the reverse of that which has been seen from rapidly increasing bank reserves.

In short, the level of prices has a definite relation to the standard of value. Following the discovery of the South African gold field, and of the cyanide method of treating ores, the world's production of gold increased rapidly, and a period of what was called "gold inflation" and rising prices ensued, lasting down to the outbreak of the war, although the rate of production was practically at a standstill for several years before the war. The amount of bank credit available before the war was related to the bank reserves, and the level of prices the world over was adjusted to this relationship. It is possible, temporarily, by the use of Government credit, to sustain a higher level of prices without

a corresponding increase of gold reserves, but it cannot be done permanently. The circulating credit must be freely convertible into the standard of value, if prices are to have any definite relation to the standard, or if prices in different countries are to have any definite relation to each other.

In short the prices of other things must come down in relation to gold if gold is to remain the standard of value. Under the present relationship gold production will stop, and bank reserves will be at a standstill until prices fall sufficiently to allow gold production to be resumed.

Substitute Standards.

Of course there are people who think that the gold standard should be abolished. Some of them are unable to understand that money must be definitely related to concrete values; that a unit of value must have value in itself, as a unit of length must have length, a unit of weight must have weight, and a unit of volume measure must have certain volume capacity. They cannot see that if the word "dollar" was not attached to some concrete thing which possessed value it would convey no idea of value whatever. Suppose that by some magic the word "bushels" was suddenly substituted for the word "dollars" wherever the latter occurs, upon money, in promissory notes and contracts, in price-lists, bank accounts, etc., what confusion would ensue!

Passing from the believers in fiat money, there is a respectable company which has written upon the idea of a multiple or composite commodity standard, the idea being to attach the currency definitely to a unit which would represent the average value of a list of staple commodities. Such a system is conceivably possible, but the unit would be a theoretical one, and, of course, conversion of the currency into standard money, for the settlement of international balances and in the automatic regulation of credits would be out of the question.

The probability is that if such a system was adopted the business world would continue to use gold as the most convenient means of settling balances, and that the currencies of the world would be quoted in terms of gold, and compared with each other in this manner.

Gold Reserves With a Commodity Standard.

Professor Irving Fisher has proposed a new feature for the commodity standard. His proposal is that we continue to base our currency upon gold, but that the amount of gold represented by the paper dollar be changed from time to time in order to maintain a substantially fixed relation between the "dollar" and the value of commodities. In other words, the "dollar" would be "corrected" from time to time to conform to prices, and to keep the average of commodity prices at a uniform level. By this means the gold dollar would be a compensating balance for the commodity unit. If the list of commodities adopted as the standard showed a tendency to rise, on the average of them all, it would be taken as a sign that gold was becoming cheaper, and this would be corrected by putting a little more gold in the dollar. If, on the other hand, prices showed a tendency to fall, this would be accepted as proof that gold was becoming dearer, and a grain or fraction thereof would be deducted from the dollar.

It will be seen that Professor Fisher's object is to stabilize prices and relate the currency and all credit instruments definitely to the prices of commodities, something in itself undoubtedly to be desired. If this system had been in force when prices began to rise, in 1915, instead of a reduction in gold contents of the dollar, or a bonus for gold mining to offset the rising costs, or any other action calculated to maintain gold production, the miners would have been promptly required to give an increased amount of gold for a dollar, and the required amount would have been increased as fast and as long as commodity prices advanced, not only to the extent of closing down the mines, but to the extent of melting down our existing gold coins to make them represent a smaller number of dollars. In other words, the system would continue to put more gold into the dollar, until the point was reached where prices in terms of gold stopped rising.

Merits of the Gold Standard.

Nobody claims that gold is an ideally perfect standard of value, or that fluctuations in prices which are due to fluctuations in the production of gold are not to be regretted. One by one, however, the countries have come to the gold standard, because it has greater advantages, stability included, than any other standard of value ever in use. It has the one great advantage over any theoretical system in its simplicity, and another great advantage in the fact that all the world has adopted it. The primary purpose of a standard is to provide a common basis on which to do business, and the business world is slow to listen to proposals which it does not readily understand, and which it is very sure other countries, for the same reason, will not readily adopt. Granted that it is very desirable to have the whole business world thinking in common terms, when you once have this accomplished no section of it is likely to be receptive to the idea of adopting a new language of values for itself.

An Inopportune Proposal.

Without going into a further discussion of Professor Fisher's proposal at this time, one comment seems to be pertinent. Since its whole purpose is to stabilize the monetary unit in relation to the level of prices, outstanding indebtedness, fixed incomes, current wages,

etc., it would seem that it should be put into force, if at all, at a time when prices were on what might be fairly called a normal basis, and bore some reasonably just relation to outstanding obligations. Professor Fisher holds that the supply of gold has been increasing unduly for about twenty years, and that even before the war his system was needed to check the abnormal and unjust rise of prices. But now, in about four years, prices have made a further advance of nearly 100 per cent. These prices are unquestionably a hardship to many people, but they are recognized as temporary. If the monetary system is unchanged a readjustment downward will take place naturally, and as the vast body of outstanding obligations in terms of money will be in the main unliquidated, the mischief will be comparatively small. Although deplorable, the injustice to individuals will be regarded as incidental to the war, and the country will escape the odium of having deliberately changed the standard value either for the benefit of a class or for the advantage of the Treasury. But to adopt Professor Fisher's plan now would be to fix these wartime inflated prices permanently, and to make certain that all obligations which are stated in terms of money would be liquidated in currency having only the purchasing power of the currency today. We do not believe this is what he intends, for his advocacy of the plan dates back of the period of war inflation, and he was prompted to this advocacy by his sense of the injustice of a depreciating dollar. Nevertheless, he may find himself supported by a company whose fundamental views are quite different from his own.

The Money Question in Politics.

It is a curious thing, the way financial heresies are revived from time to time, with all the fervor that characterize the original discovery of an idea, and restated as positively and prophetically as though they had not been exploded and discredited by experience again and again.

The inflated and depreciated currency of our Civil War times was the source of many ills, but the only thing to do, for the protection of the national credit and for the establishment of a solid financial basis for prosperity, was to keep the nation's promise to redeem the greenbacks in gold. But a formidable opposition party developed, who argued that the greenbacks had never depreciated, but that gold had risen in value, and that nobody but Wall Street was interested in bringing the paper money to a fixed relation with gold. It prophesied that gold payments could not be maintained, and that to attempt it would be to make money scarce and dear, and forbid the development and prosperity of the country. But the resumption of gold payments inaugurated one of the greatest periods of development and prosperity in the history of the country.

The agitation for the free coinage of silver repeated all the catch-words and prophesies of the greenback period. It was plaintively declared that mankind was about to be crucified upon a cross of gold. The country could never know prosperity again unless silver was admitted to free coinage at the ratio of 16 to 1. But by the time the next election came around the silver question, which had been presented as an issue involving nothing less than the cause of human freedom, was so dead that it was scarcely mentioned.

But through all its defeats and exposures the main fallacy survives. That fallacy is in the idea that the return swing of the pendulum from a period of inflation is the work of bankers and other rich conspirators, and that the maintenance of the gold standard is in the interest of the same class, and opposed to the interests of the masses of the people.

The Fallacy of Cheap Money.

That this idea is lurking now is apparent from signs which appear from time to time. A correspondent bank in a western state, which has been distributing this Bulletin to its patrons, sends us a letter it has received, of which the following is a copy:

"I read with much pleasure the monthly reports from The National City Bank, particularly as it is falling into line and admitting that humanity is greater than money. In the September issue it is wrong when, referring to the national debt and the payment, it says, "when it will take twice as much in labor and commodities to pay a dollar of debt as the Government receives now." This will never come to pass. The debt will be paid on the basis on which it was contracted, and our debt will be so big that there will not be enough gold in the United States to wad a shot-gun with outside of what will be in government banks, and the money will be based on products, etc., and their bank credit value fixed by the Government, and not the speculator.

Here is the old fallacy, that humanity is interested in a dollar of low purchasing power. There are about 16,000,000 life insurance policies outstanding in this country, including memberships in the fraternal orders, but not including industrial insurance, and these policies represent promises to pay in the aggregate over $30,000,000,000, in most cases upon the death of the insured to dependent members of his family. Most of these policies are of many years standing, and have been paid for from year to year in money of the existing standard. Under the stress of the war the value of money, unavoidably and unfortunately, is temporarily depreciated, but would it help to elevate humanity above money to make this temporary depreciation permanent, and have all these policies, as they mature, paid in money of one-half the value of the standard in which the contracts were written?

The same question may be asked about the $26,000,000,000 of bank deposits, many of them savings deposits which have been slowly and painfully accumulated, and the millions of like funds in savings and loan associations and real estate mortgages.

These are not the investments of the rich. The rich do not have their wealth in money. They are owners of property, operators of business enterprises, producers of goods and borrowers of money.

Bankers are not gainers by an appreciating currency, or by any condition which works adversely to the interests of the public. Bankers are dealers in credit. They owe and pay to the public the same kind of money they receive, and their loans and deposits are practically equal. They gain by the growth in volume of deposits, which is greatest in a state of general prosperity.

It is a grave mistake to assume that a class which is as intimately related to the business activities of the country as the bankers can gain by any policy which restricts the prosperous development of industry and trade. All interests are best served by policies which promote the creation of wealth throughout the community.

Wage-Earners Interested in a Stable Currency.

The wage-earners have nothing to gain by depreciating the value of money. The imperative demands for labor occasioned by the war, together with the withdrawal of so many men from industry for the ranks of the army and navy, has made it possible for wages to advance with unusual rapidity, but all authorities agree that as a rule it is difficult for wage-earners to better their condition in a period when the purchasing power of money is declining. At such times they must have frequent wage advances to simply hold their own. The greatest gains of the wage-earning class in the paper money period of the Civil War were not made while the money was declining in value, but when it was regaining purchasing power, or, in other words, after living costs had begun to fall. The wage-earner then had only to contend against a reduction of the wage rate, while his income brought him a steadily increasing amount of goods.

The greatest losses to the wage-earning class, however, come from a period of uncertainty and hesitation in the business community, when confidence is impaired, enterprise slows down, construction work ceases and workers by the thousands walk the streets in search of jobs.

Employment and prosperity after the war are dependent upon confidence and good understanding in industry, and an attack upon the standard of value would do inestimable injury to all classes. A period of falling prices has its perils to be foreseen and guarded against, but the conditions represent a normal and necessary reaction from an excessive movement in the other direction, and when the balance is restored, confidence in the natural order is restored, and the way is clear for prosperity on an assured basis. When arbitrary and impulsive legislation is resorted to, there remains no basis upon which to calculate the future.

The Public Debt.

This correspondent lays emphasis upon our prediction that the Government will have to pay its debt with dollars of a higher purchasing value, perhaps two for one, than those with which its expenditures are made. This is true, but only another way of stating the familiar fact that war of itself increases all costs. It would be quite out of the question to plan for carrying on a war at a time when things were cheap, or to keep things cheap during a war. The rise of prices is part of the inevitable cost of war, but it is aggravated by the economic ignorance of the public and the failure to promptly curtail private consumption to make way for the necessary demands of the government. It is because we persistently violate the economic law that the purchasing power of money depreciates so seriously. Ignorance and improvidence are always costly, but they afford a poor excuse for national repudiation.

There is a way, however, by which the people may protect themselves against the cost of bearing and paying the debt after the war is over. They can buy enough of the Liberty Bonds or War Savings Stamps while wages and the prices of products are high, to cover their share of the debt, so that when they pay taxes to meet the interest or principal their payments will pass through the Treasury and back into their own pockets. Now is the time, while money is cheap and wages and products are high, to put enough money into bonds to provide for the debt burden so far as each individual is concerned.

And millions of people are doing it. The debt is being widely distributed, thus making it a certainty that the payments upon it instead of going to bankers and a small group of the rich, will be distributed among the masses of the people. A debt held in this manner is not a serious burden.

The increased volume of long term indebtedness will not affect the gold standard, as no reserves are kept against such indebtedness.

We appreciate the friendly opinion which has resulted from reading the Bulletin, that this Bank is "falling into line and admitting that humanity is greater than money," and beg to reciprocate with assurance that the writer is just beginning to understand Wall Street's views.

The Bond Market.

During the interim between the Third and Fourth Liberty loans corporation issues, in which are included rails, public utilities and industrials, aggregated $451,901,000, and municipal issues totaled $123,764,000. Prices have scarcely varied from those prevailing before the Third Liberty loan.

The average price of 40 standard issues, as reported by the *Wall Street Journal* on Septem-

ber 27, was 81.99, compared with 82.80 on August 27, and 88.12 on September 27, 1917.

During the next three weeks bond houses anticipate only a limited inquiry for short term notes and business will probably be at the low ebb of the year, for all the organizations are now engaged in Liberty Loan activities.

During the past month activity has been confined largely to United States Government and foreign issues. The military success in Europe has been followed by advances in foreign government issues, many of which have reached new high prices for the year.

During the middle of the month there were sensational fluctuations in Liberty Bonds as the result of Secretary McAdoo's recommendation relative to tax exemption privileges. These fluctuations resulted in advances of three points on the 4s and 4¼s. Toward the close of the month the market was somewhat reactionary and very quiet except in government issues. Upon the announcement of the new Liberty Loan, trading in the old issues became active.

French 5½s due April, 1919, reached 101⅜, compared with 91½ last December.

August Offerings.

New offerings during the month included:

$33,400,000 Interborough Rapid Transit Conv. 7% Notes, due Sept. 1, 1921, at 98½ and interest, to yield 7.50%.
5,500,000 Monongahela Valley Traction Co. 7% Bonds, due July 1, 1923, at 97 and interest, to yield 7.75%.
400,000 Moran & Co., San Francisco (Packers), 7% Bonds, due August 1, 1921-23, at prices to yield 7.75%.
325,000 Oklahoma Power & Transmission Co. 6% Bonds, due July 1, 1923, at 93 and interest, to yield about 7.75%.
1,500,000 Pennsylvania Electric Co. 7% Notes, due July 1, 1923, at 97½ and interest, to yield 7.75%.
3,900,000 Rochester Railway & Light Co. 7% Bonds, due Sept. 1, 1921, at 98 and interest, to yield 7.75%.
500,000 Stewart Manufacturing Corp. R. E. 6% Bonds, due July 1, 1920-24, at prices to yield 7%.
690,000 Western States Gas & Electric Co. 6½% Notes, due August 1, 1923, at 98 and interest, to yield about 7%.

Throughout the month municipal bonds have experienced considerable uncertainty as the result of tax legislation, and as the month progressed bidders at public sales became more cautious, with resultant lower bids.

New municipal offerings included:

$1,725,000 City of Newark, N. J., 5% Bonds on a 4.60% basis.
113,592 City of Paterson, N. J., 5% Bonds on a 4.70%-4.75% basis.
370,000 Chester School District, Pa., 4½% Bonds on a 4.30% basis.
500,000 Hamilton County, Ohio, 5% Bonds, on a 4.75% basis.
135,000 Hanover Township (Luzerne Co.), Pa., 4½% Bonds on a 4.30% basis.
157,000 Indian Grave Drainage District, Ill., 6% Bonds on a 6% basis.
288,000 Middlesex County, N. J., Funding 4¾% Bonds on a 4.55%-4.60% basis.
239,000 Passaic County, N. J., 5% Bonds on a 4.60% basis.
256,000 Palo Verde Joint Levee District, Cal., 6½% Bonds on a 5½%-6% basis.
313,000 Polk County, Iowa, 5% Funding Bonds on a 4.70% basis.
1,000,000 Portland, Oregon, 4½% Bonds on a 4.90% basis.
250,000 Rochester, New York, 5% Notes on a 4.15% basis.
600,000 State of Delaware 4½% Bonds on a 4.55% basis.
320,000 Syracuse, New York, 4¾% Bonds on a 4.45% basis.
101,000 Town of Nutley, N. J., 5% Bonds on a 4.75% basis.
100,000 Joilet City School, Illinois, 5% Bonds on a 4.60% basis.
240,000 Stamford, Texas, 5% Bonds on a 5.20% basis.

War Finance Corporation.

The War Finance Corporation since its inception has rendered assistance in several public utility situations. It assisted in underwriting $33,000,000 Interborough Rapid Transit Notes. It advanced about $2,400,000 to the Commonwealth Power, Railway & Light Company in refunding an $8,000,000 note issue. It underwrote about 30% of the maturing $17,000,000 issue of Brooklyn Rapid Transit notes. It advanced $3,235,000 to the United Railways of St. Louis. It assisted to the extent of about $1,000,000 in refunding the New Orleans Railway & Light $4,000,000 note issue, maturing June 1. It assisted the Aurora, Elgin & Chicago Railroad to the extent of about $219,000.

This assistance has relieved the minds of holders of public utility securities, which until assistance was rendered found it necessary to form protective committees.

Essential Industries Corporation.

In order to render further assistance to the public utility situation, the Essential Industries Corporation has been incorporated in New York which, according to newspaper reports, has an initial capital of $3,000,000, consisting of $1,000,000 stock, $1,800,000 ten-year debentures and $200,000 cash surplus. This corporation was formed by some of the leading banks, investment houses and industrial and public utility companies. It is proposed that the corporation will make loans to public utility companies and in turn will avail itself of the provision of the War Finance Act by rehypothecating the notes and securities which it receives from the corporations. It is stated that the capital will be increased from time to time as the business demands to an ultimate amount of approximately $20,000,000. Latest reports advise that one of the first companies to receive aid will be the Portland Railway, Light & Power, and in due course the following companies which are in need of assistance will probably be considered: Atlantic City Gas Company, Paducah City Railway Company, and Alton, Granite & St. Louis Tranction Company.

Street Railway Fares.

The American Electric Railway Association compiles a continuous tabulation of increases in railway fares, which up to a recent date shows that 3 cities now have a 10-cent fare, 43 cities now have a 7-cent fare, over 100 cities have a 6-cent fare, and there are other situations where a 5-cent fare exists with additional charge for transfers or increased fares outside of a certain central zone.

According to the calculation, up to September 15, 270 increases in fares had been granted, of which 24 have been granted since July 1, 1918. It further states that about one-quarter of the urban population of the country, or about 12,000,000 out of about 41,000,000 people, are now paying more than the standard 5-cent fare for street car service. In regard to the general question of public utility increases in

rates, another committee located in Washington has recently reported that since January 1, 1918, there have been granted between 600 and 700 rate increases.

Taxing Municipal Bonds.

The pending revenue bill as passed by the House includes for taxation income from municipal bonds and other obligations of States and sub-divisions of a State, when issued subsequent to the passage of this act. Such obligations heretofore have been exempt from Federal taxation, and the new policy raises an important constitutional question.

The Supreme Court of the United States has held repeatedly that the Constitution contemplates the independent exercise by the Nation and the States, severally, of their constitutional powers, and that for either to tax the obligations of the other would amount to power of interference in the exercise of independent and necessary functions.

In the case of Pollock v. Farmers Loan & Trust Co., 157, U. S., where the Supreme Court by a vote of 5 to 4 held the income tax law of 1894 to be invalid, there was no disagreement in the Court upon this phase of the subject. It held unanimously that the Federal Government was without power to tax the obligations of a State or any sub-division of a State, that taxation upon the interest derived from such obligations would operate on the power to borrow before it was exercised and have a sensible influence upon the contract, and therefore a tax upon the income derived from such securities would be a tax on the power of the States and their instrumentalities to borrow money, which would be repugnant to the spirit of the Constitution.

The argument for the constitutionality of such a tax is now based on the recent amendment to the Constitution, which reads as follows:

Article 16—The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States and without regard to any census or enumeration.

This amendment, standing alone, would seem to confer power upon the Congress to levy taxes upon incomes "from whatever source derived," including income from the obligations of a State, but the weight of legal opinion apparently is against this interpretation. It is held in opposition that this amendment was never intended to enlarge the taxing power of the Federal Government, but only to enable it to levy a tax upon incomes derived from real estate or personal property without apportioning it among the States. The Supreme Court had held, 5 to 4, that such a tax could not be levied directly, but must be apportioned among the several States on the basis of population—a method which all agreed was impracticable under latter-day conditions; but the Court at the same time had held unanimously that the Congress was without power to tax the obligations of a State. It is strongly argued that the amendment was directed to the former inability but not to the latter, and that the Congress in proposing the amendment was seeking solely to remedy the effect of the 5 to 4 decision, and giving little or no thought to the point upon which the Court was unanimous.

Practical Aspects of Exemption.

Passing from the legal aspects of the case, there is much to be said in favor of subjecting State and municipal bonds,or the income therefrom, to the Federal taxation. They are subject to State and local taxation, except where made exempt within the State of issue. The amount of such securities outstanding is approximately $5,000,000,000, a very large sum to be exempt from any and all burdens which the National Government may have to assume. Moreover, the amount is increasing rapidly, and the privilege of exemption during a period when Federal taxation is heavy will have a tendency to encourage municipal undertakings on an extensive and possibly an impracticable scale. It is not in the public interest that municipal undertaking should be promoted in such manner. If municipalities are going into all sorts of business enterprises they should be held to account upon business principles, and required to demonstrate their ability to conduct them upon the same basis of costs as that upon which private owners must conduct enterprises of the same kind.

The public is compensated in some degree for the loss of tax revenues by lower interest rates upon money borrowed, but these benefits are restricted in their distribution and do not reach the same people who suffer by the exemptions. Why, for instance, should the farmers everywhere pay higher taxes in order that municipalities should borrow money more cheaply?

On the other hand, we have the exemption of Federal Land Bank bonds for the purpose of promoting agricultural development, an object in itself highly desirable, but which does not require a subsidy. If the Federal and State governments go on creating exemption privileges in this manner the task of distributing the burdens of government will become infinitely complex and troublesome. The benefits of such exemptions are so irregularly and unequally bestowed, and involved in so much obscurity that there is great uncertainty about who gets them. Although exemptions are always granted to favor certain groups of borrowers, the lenders have to take all the criticism and blame. They are invited by legislation and the public authorities to buy the securities upon the terms offered, and might reasonably assume that their action would have public approval, but having made the purchases they are quite sure to find themselves re-

garded as a privileged class. In the interest of good understanding and social peace it is desirable that there shall be no occasion or excuse for grievance of this kind.

Federal Land Bank 5 per cent bonds, as a result, of the exemption provision, are selling at a premium of 4 to 5 per cent.

The Farm Mortgage Bankers' Association of America is vigorously challenging the policy of exempting Federal Land Bank bonds from taxation. Mr. Chassell, its Secretary, in a recent article calls attention to "H. R. No. 8827," a bill now pending to establish personal credit banks, to be operated in conjunction with the Federal Land Banks, all capital employed to free of taxation, and sums up the argument against tax-exempt securities as follows:

The great problem of the present time is to equalize the burden of taxation so that all persons and property may bear their just proportions. If one class of property is relieved from taxation, it to the same extent adds to the taxes borne by other property. The gross amount of taxes raised is not reduced. The expenses of the government must be met. The taxes are apportioned to the persons and property subject to taxation.

A continuance of our present reckless system of exempting securities from taxation will result in the creation of a favored class of tax exempt aristocrats who, while enjoying all the benefits of public utilities and police protection, wil contribute nothing to their maintenance. This situation will also cause serious dissatisfaction among the masses of wage earners and property holders who will resent the injustice of being compelled to carry the entire burden.

It is impossible now and it would be unjust, if possible, to enact any laws depriving securities already issued of their tax exemption features. The remedy will be to enact laws requiring future issues of securities to bear their just proportions of the public burden. Congress can correct the blunders of the past regarding future issues of Federal Land Bank bonds and it can prevent the exemption of Personal Credit Bank bonds. The several states regulate the taxation of their municipal securities and no state will be dependent upon other states or upon national legislation in enacting laws requiring future issues of local securities to bear their fair share of local taxes.

In the State of Ohio, six years ago, an inquiry developed that outstanding securities issued without the state and tax-exempt within the state aggregated $218,754,113, and moved by this showing the legislature repealed the exemption privilege as applied to future issues.

STATEMENT OF RESOURCES AND LIABILITIES OF EACH OF THE TWELVE FEDERAL RESERVE BANKS AT THE CLOSE OF BUSINESS SEPTEMBER 27, 1918.

(In Thousands of Dollars)

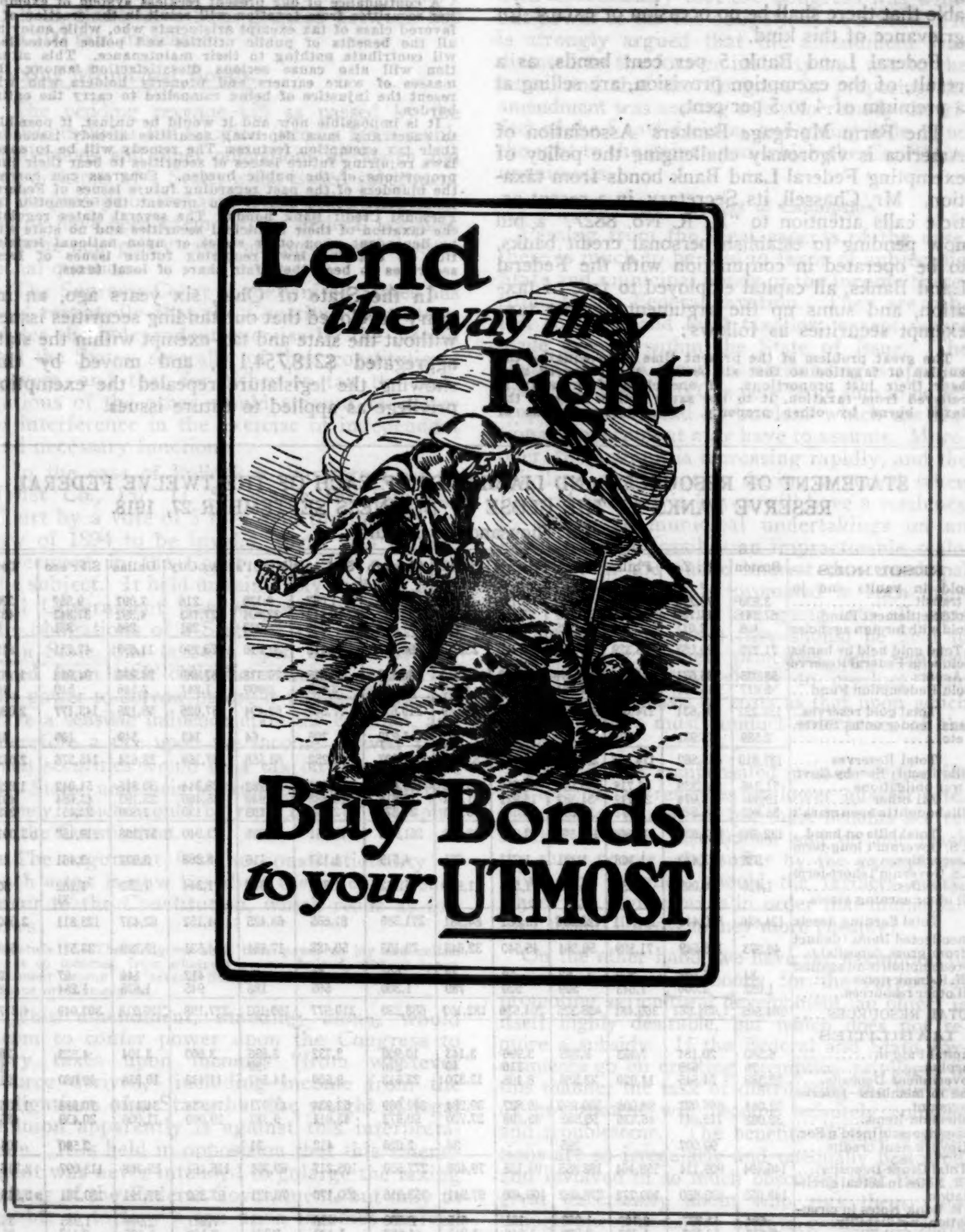
RESOURCES	Boston	N. Y.	Phila.	Clev'd	Rich'd	Atlanta	Chicago	St. Louis	M'npl's	Kas.City	Dallas	S.Fr'sco	Total
Gold in vaults and in transit	3,630	273,296	266	27,862	6,198	6,733	26,109	1,067	8,179	216	7,097	9,567	370,229
Gold Settlement Fund	67,241	14,760	57,655	70,877	28,088	17,042	72,022	16,812	22,804	27,783	4,392	37,843	437,319
Gold with foreign agencies	408	2,011	408	525	204	175	816	233	233	291	204	321	5,829
Total gold held by banks	71,279	290,067	58,329	99,264	34,490	23,950	98,947	18,112	31,216	28,290	11,693	47,731	813,368
Gold with Federal Reserve Agents	58,925	286,671	110,208	153,479	47,293	36,340	206,111	56,615	29,378	57,489	24,286	94,936	1,161,731
Gold Redemption Fund	5,017	14,893	5,500	1,231	614	3,259	5,577	2,820	2,900	1,247	2,146	510	45,714
Total gold reserves	135,221	591,631	174,037	253,974	82,397	63,549	310,635	77,547	63,494	87,026	38,125	143,177	2,020,813
Legal tender notes, Silver, etc	2,589	43,931	791	310	628	183	1,272	705	64	142	549	199	51,368
Total Reserves	137,810	635,562	174,828	254,284	83,025	63,732	311,907	78,252	63,558	87,168	38,674	145,376	2,072,176
Bills disctd: Sec. by Govt. war obligations	71,246	564,288	86,718	50,597	48,751	45,133	169,044	50,293	25,262	28,344	30,815	51,042	1,221,538
All other	15,594	113,074	21,112	34,382	18,921	31,051	72,618	26,888	41,940	45,460	25,193	45,664	491,897
Bills bought in open mark't	35,842	155,575	7,976	32,016	4,586	6,104	20,272	2,000	133	136	1,300	22,451	288,391
Total bills on hand	122,682	832,937	115,806	116,995	72,258	82,288	261,934	79,181	67,335	73,940	57,308	119,157	b2,001,821
U. S. Governm't long-term securities	538	1,410	1,348	1,291	1,233	631	4,519	1,153	116	8,868	3,977	3,461	28,546
U.S. Governm't short-term securities	1,416	26,099	4,257	3,760	1,510	1,991	5,112	1,321	974	1,344	1,152	1,162	50,098
All other earning assets						71						31	108
Total Earning Assets	124,636	860,446	121,411	122,046	75,001	84,981	271,565	81,655	68,425	84,152	62,437	123,811	2,080,566
Uncollected Items (deduct from gross deposits)	40,973	155,649	71,399	56,364	45,540	32,643	73,153	50,483	17,884	54,521	17,328	33,511	649,448
5% redemption fund against F. R. bank notes	34	1,024	200	62	50	47	305	22	50	412	144	97	2,447
All other resources	1,052	2,000	1,643	569	920	789	1,300	565	186	945	1,635	1,254	12,858
TOTAL RESOURCES	304,505	1,654,681	369,481	433,325	204,536	182,192	658,230	210,977	150,103	227,198	120,218	302,049	4,817,496
LIABILITIES													
Capital Paid in	6,580	20,184	7,353	8,785	3,996	3,143	10,906	3,732	2,896	3,600	3,104	4,523	78,802
Surplus	75	649			116	40	216		38				1,134
Government Deposits	22,388	24,645	14,020	22,586	8,103	12,370	22,513	9,560	14,587	11,433	10,338	19,080	191,628
Due to members—reserve account	92,044	666,021	98,008	109,992	49,827	39,284	202,039	52,234	44,971	75,658	34,424	70,988	1,535,490
Collection Items	32,062	119,441	46,436	59,982	35,198	27,720	50,972	43,011	9,722	29,070	11,006	20,439	485,050
Other deposits incld'g For. Government credits		99,007		295		34	2,026	412	21			2,590	104,386
Total Gross Deposits	146,494	909,114	158,464	192,855	93,128	79,408	277,550	105,217	69,301	116,161	55,768	113,097	2,316,557
F. R. Notes in actual circulation	148,053	699,650	199,772	228,082	105,499	97,941	358,816	100,170	76,421	97,350	57,191	180,381	a2,349,326
F. R. Bank Notes in circulation, net liability	684	11,777	2,109	1,083	151	615	6,060	436	73	7,927	2,969	1,935	35,819
All other Liabilities	2,619	13,307	1,783	2,520	1,646	1,045	4,682	1,422	1,374	2,160	1,186	2,113	35,857
TOTAL LIABILITIES	304,505	1,654,681	369,481	433,325	204,536	182,192	658,230	210,977	150,103	227,198	120,218	302,049	4,817,495

(a) Total Reserve notes in circulation, 2,349,326.

(b) Bills discounted and bought; U. S. Government short term securities; municipal warrants, etc.: 1—15 days 1,337,362; 16—30 days 192,455; 31–60 days 303,185; 61 90 days 172,114; over 90 days 46,874. Total 2,051,990.

Ratio of gold reserves to net deposit and Federal Reserve note liabilities combined 63.4%. Ratio of total reserves to net deposit and Federal Reserve note liabilities combined 77.0%.

DISCOUNT RATES: The discount rates of each Federal Reserve Bank approved by the Federal Reserve Board, remain unchanged from previous publication, with the following exceptions: Within 15 days Atlanta 4¼%, Minneapolis 4½%, Dallas 4½%. 16-60 days, Kansas City 5%. 61-90 days, Kansas City 5%.


Lend
the way they
Fight
Buy Bonds
to your UTMOST